

Message Text

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ACTION EUR-25

INFO OCT-01 IO-13 ADP-00 AID-20 CEA-02 CIAE-00 COME-00

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OPIC-12 TRSE-00 CIEP-02 LAB-06 SIL-01 OMB-01 STR-08

SS-15 NSC-10 L-03 H-03 PRS-01 PA-03 USIA-15 AGR-20

TAR-02 RSR-01 /209 W

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R 091723Z AUG 73

FM USMISSION EC BRUSSELS

TO SECSTATE WASHDC 5647

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

AMEMBASSY LONDON

AMEMBASSY LUXEMBOURG

AMEMBASSY PARIS

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PASS TREASURY, FRB AND CEA

E.O. 11652: NA

TAGS: EEC, EFIN

SUBJ: ECONOMIC AND MONETARY UNION -- EC COMMISSION

REPORT ON PROGRESSIVE POOLING OF RESERVES

AND ADJUSTMENT OF SHORT-TERM MONETARY SUPPORT

REF: EC BRUSSELS 3642, PARA. 4

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1. SUMMARY. THE EC COMMISSIN'S REPORT TO THE COUNCIL

(POUCHED TO EUR/RPE ON JULY 2, 1973) HAS NOT YET BEEN SERIOUSLY STUDIED IN THE COMMUNITY. THE FIRST REACTION OF MANY OF OUR CONTACTS, HOWEVER, IS THAT THE PROPOSAL IS A BOLD ONE CONTAINING A NOVEL EMPHASIS ON PROGRESSIVE POOLING OF RESERVES DENOMINATED IN A UNIT OF ACCOUNT THAT WOULD BECOME A SETTLEMENT AND RESERVE INSTRUMENT. PRELIMINARY INDICATIONS HERE ARE THAT THE UK, ITALY AND THE SMALLER MEMBER STATES -- WHILE NOT NECESSARILY ADVOCATING EARLY ACTION -- GENERALLY FAVOR THE PROPOSAL WHILE THE GERMANS AND FRENCH ARE FAR MORE RETICENT. THE MONETARY AND CENTRAL BANK GOVERNORS' COMMITTEES AND THE SO-CALLED THERON GROUP WILL SUBMIT REPORTS ON THE PROPOSAL, AND THE EC FINANCE MINISTERS MAY HAVE AN INITIAL DISCUSSION OF IT BY LATE OCTOBER. OUR SOURCES TELL US THERE MAY BE POLITICAL PRESSURE TO TAKE SOME CONCRETE ACTION, EVEN IF LARGELY SYMBOLIC, BY THE BEGINNING OF 1974. END SUMMARY.

2. THE COMMISSION'S PAPER ON PROGRESSIVE POOLING OF RESERVES AND ADJUSTMENT OF SHORT-TERM MONETARY SUPPORT ARRANGEMENTS GREW OUT OF THE COMMUNITY'S COMMITMENT TO ESTABLISH ECONOMIC AND MONETARY UNION BY DECEMBER 31, 1980, A COMMITMENT WHICH, AS THE COMMISSION'S PAPER NOTES, WAS REAFFIRMED BY THE EC SUMMIT IN OCTOBER 1972. THE PAPER DEALS PRINCIPALLY WITH THE CONDITIONS FOR PROGRESSIVE POOLING OF RESERVES AND IMPROVEMENT OF COMMUNITY CREDIT MACHINERY. IT ALSO STRESSES THE IMPORTANCE OF A) STRENGTHENING COORDINATION OF MEMBER STATE MONETARY POLICIES; B) JOINT ACTION ON INTERNATIONAL MONETARY PROBLEMS, AND C) GIVING THE COMMUNITY "A WATCHING BRIEF" ON CHANGES IN COMMUNITY EXCHANGE RATE RELATIONS. WITH REGARD TO THE LATTER POINT, THE PAPER SAYS THAT AS A RESULT OF GROWING ECONOMIC INTERDEPENDENCE WITHIN THE COMMUNITY, AN EXCHANGE RATE POLICY MUST ALLOW FOR "COMMUNITY DIMENSIONS AND NOT BE THE SOLE RESPONSIBILITY OF THE MEMBER STATES". WE BELIEVE THE COMMISSION'S VIEW ON EXCHANGE RATES IS NOTEWORTHY IF ONLY BECAUSE IT WAS SURROUNDED WITH CONTROVERSY WHEN IT APPEARED IN THE ORIGINAL DRAFT AND FACED POSSIBLE ELIMINATION IN THE FINAL VERSION.

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3. THE COMMISSION PROPOSES THREE FUNDAMENTAL MEASURES IN ITS REPORT:

(A) ENDOWMENT OF THE MONETARY COOPERATION FUND WITH AN INITIAL CAPITAL OF 500 MILLION UNITS OF ACCOUNT (ONE UNIT OF ACCOUNT EQUALS \$1.2063) SUBSCRIBED IN COMMUNITY CURRENCIES AND APPORTIONED BETWEEN THE

MEMBER STATES ON THE SAME SCALE ESTABLISHED FOR SHORT-TERM MONETARY SUPPORT. THIS CAPITALIZATION WOULD BE THE FINANCIAL COUNTERPART OF THE FUND'S LEGAL PERSONALITY AND WOULD BE USED TO FINANCE OPERATING EXPENDITURES.

(B) PROGRESSIVE POOLING OF RESERVE ASSETS (GOLD, GOLD-LINKED ASSETS, AND DOLLARS) BEGINNING WITH AN INITIAL CONTRIBUTION OF 20 PERCENT ON JANUARY 1, 1974, AND ENDING WITH COMPLETE POOLING IN 1980. THE INITIAL POOLING WOULD AMOUNT TO 11.3 BILLION UNITS OF ACCOUNT FOR THE COMMUNITY AS A WHOLE. THE PROBLEM OF VALUATION OF GOLD WOULD BE EXAMINED SUBSEQUENTLY WHEN A NEW PRICE FOR GOLD WAS AGREED UPON AT THE INTERNATIONAL LEVEL OR BETWEEN COMMUNITY CENTRAL BANKS.

(C) IMPROVEMENT AND SIMPLIFICATION OF THE COMMUNITY'S CREDIT MACHINERY THROUGH THE FUND WITH FACILITIES FOR UNINTERRUPTED CREDIT RANGING FROM THE VERY SHORT-TERM ONE MONTH CREDITS TO LONGER TERM LOANS SUBJECT TO SPECIFIC ECONOMIC POLICY CONDITIONS. SHORT-TERM CREDIT WOULD BE SIX TIMES GREATER THAN AT PRESENT WITH THE TOTAL CREDIT AVAILABLE TO A CENTRAL BANK REACHING 8.175 BILLION UNITS OF ACCOUNT.

4. GOING BEYOND PREVIOUS REPORTS AND PROPOSALS, THE COMMISSION'S PAPER CALLS FOR MEMBER STATE BALANCES WITH THE FUND TO BE "DENOMINATED IN EUROPEAN MONETARY UNITS OF ACCOUNT, WHICH WOULD BECOME A SETTLEMENT AND RESERVE INSTRUMENT...AVAILABLE FOR THE SETTLEMENT OF POSITIONS ARISING FROM INTERVENTION IN COMMUNITY CURRENCIES AND EXCHANGEABLE IN THE FUND FOR FOREIGN EXCHANGE TO FINANCE INTERVENTION VIS-A-VIS THIRD CURRENCIES".
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5. COMMISSION OFFICIALS HAVE TOLD US THE UNIT OF ACCOUNT WOULD NOT BE HELD OUTSIDE EC CENTRAL BANKS AND THAT, SINCE USE OF THE UNIT OF ACCOUNT AS A VEHICLE OF INTERVENTION GOES WELL BEYOND THE SCOPE OF THE PROPOSAL, THE NOTION OF A COMMUNITY RESERVE "ASSET" MIGHT BE MORE APPROPRIATE THAN A RESERVE "INSTRUMENT". THEY ALSO SAY THEY ARE WELL AWARE OF THE DISADVANTAGES OF RESERVE CURRENCIES AND HAVE NO INTENTION OF CREATING ONE IF IT CAN BE AVOIDED. AT THE SAME TIME, THEY BELIEVE THAT AS THE COMMUNITY EVOLVES INTO A MORE COHESIVE MONETARY AREA, A UNIT OF ACCOUNT WITH A GUARANTEED VALUE IS ESSENTIAL TO INDUCE CREDITOR MEMBER STATES TO HOLD CLAIMS AGAINST THE FUND, WHICH UNDER THE COMMISSION'S PROPOSAL WOULD CONSTITUTE

RESERVE ASSETS.

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6. ALTHOUGH THE COMMISSION'S REPORT HAS NOT YET
RECEIVED SERIOUS STUDY IN THE COMMUNITY, THE MONETARY
AND CENTRAL BANK GOVERNORS' COMMITTEES HAVE BEEN
REQUESTED TO PRODUCE REPORTS ON THE PROPOSAL AND THE
THERON GROUP (A WORKING GROUP OF THE CENTRAL BANK
GOVERNORS COMMITTEE) WILL PRODUCE A BRIEF APPRAISAL BY
LATE SEPTEMBER. PERMANENT REPRESENTATION SOURCES TELL

US THERE MAY BE SOME INITIAL DISCUSSION OF THE PAPER
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BY THE EC FINANCE MINISTERS WHEN THEY MEET IN LATE
OCTOBER.

7. A NUMBER OF TECHNICAL PROBLEMS ARE NOT DEALT WITH
IN THE REPORT AND WILL OF COURSE HAVE TO BE FACED
IN THE EVENT ANY RESERVE POOLING DOES ACTUALLY TAKE
PLACE. ONE OF THE MORE OBVIOUS PROBLEMS IS THE RE-
LATIONSHIP OF THE UNIT OF ACCOUNT TO GOLD AND NATIONAL
CURRENCIES. EC MONETARY AUTHORITIES WILL HAVE TO
DECIDE WHAT WILL HAPPEN IF A MEMBER STATE'S CURRENCY
APPRECIATES OR DEPRECIATES FOLLOWING A CONTRIBUTION
TO THE FUND AND RECEIPT BY A MEMBER STATE OF A UNIT OF
ACCOUNT CREDIT WITH A GUARANTEED VALUE. THERE MAY ALSO BE A
PROBLEM OF BALANCING THE FUND'S ASSETS AGAINST ITS LIABILITIES,
SINCE THE LATTER WOULD HAVE A GUARANTEED VALUE IN THE
FORM OF CLAIMS AGAINST THE FUND WHEREAS ASSETS IN
NATIONAL CURRENCIES WOULD NOT.

8. ALTHOUGH NO FIRM POSITIONS OF MEMBER STATES TOWARDS
THE PROPOSAL HAVE EMERGED AS YET, PRELIMINARY INDICA-
TIONS HERE ARE THAT THE UK AND ITALY, ALONG WITH THE
SMALLER MEMBER STATES, GENERALLY FAVOR THE PROPOSAL
THOUGH NOT NECESSARILY RAPID ACTION ON IT. THE DUTCH,
EVEN IF GENERALLY IN FAVOR FROM THE POINT OF VIEW
OF COMMUNITY SOLIDARITY, ARE MORE RELUCTANT ABOUT THE
CREDIT IMPLICATIONS OF RESERVE POOLING. THE GERMANS
ARE ALSO SAID TO BE RETICENT FOR SIMILAR REASONS AND
ARE BELIEVED TO PREFER A MORE PRAGMATIC APPROACH WITH
LESS EMPHASIS ON MONETARY INITIATIVES AND MORE ON
COORDINATION OF ECONOMIC POLICIES. THE FRENCH ARE
ALSO REPORTEDLY UNENTHUSIASTIC ABOUT THE IMPLICATIONS
OF THE PROPOSAL FOR MEMBER STATE SOVEREIGNTY IN MONETARY
AFFAIRS.

9. ALTHOUGH THESE POSITIONS DO NOT AUGUR WELL FOR A
UNANIMOUS DECISION BY THE MEMBER STATES TO POOL 20
PERCENT OF THEIR RESERVES BY JANUARY 1, 1974, THE
COMMISSION, WITH THE SUPPORT OF SOME MEMBER STATES, WILL
MOST LIKELY PRESS FOR MOVING AHEAD ON SCHEDULE IN
ACCORDANCE WITH THE MANDATE OF THE OCTOBER 1972 SUMMIT.
THERE IS THUS A CHANCE THAT SOME CONCRETE STEPS, PERHAPS
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LARGELY SYMBOLIC AND CERTAINLY FALLING WELL SHORT OF WHAT THE COMMISSION PROPOSES, MIGHT BE TAKEN. ONE OF OUR PERM REP CONTACTS FROM A MEMBER STATE GENERALLY FAVORING THE PROPOSAL SAYS THAT THE DANGER IS PRECISELY THAT, DESPITE CONSIDERABLE OPPOSITION, THE POLITICAL PRESSURE TO DO "SOMETHING" MAY LEAD TO HASTY HALF STEPS WHEN IT MIGHT BE IN EVERYONE'S INTEREST TO MOVE MORE SLOWLY.

10. THE POOLING OF EVEN 20 PERCENT OF MEMBER STATE RESERVES MIGHT SEEM HIGHLY THEORETICAL IN THE CURRENT CLIMATE OF PESSIMISM ABOUT EARLY PROGRESS TOWARD ECONOMIC AND MONETARY UNION -- SYMBOLIZED BY AN EC SNAKE CONSIDERED FRAGILE EVEN WITHOUT THE POUND AND THE LIRA. IN PRESENTING ITS PROPOSAL, HOWEVER, THE COMMISSION WAS DETERMINED TO FULFILL THE MANDATE GIVEN IT BY THE EC SUMMIT. SHOULD THIS CLIMATE OF PESSIMISM CHANGE, WHETHER BECAUSE OF GROWING INTERNATIONAL MONETARY STABILITY OR DEVELOPMENTS WITHIN THE COMMUNITY OR BOTH, IT IS LIKELY THE COMMISSION'S IDEAS ON RESERVE POOLING WILL BE VIEWED AS AN INTEGRAL AND IMPORTANT PART OF THE CREATION OF ECONOMIC AND MONETARY UNION. (THE MISSION IS POUCHING TO EUR/RPE FOUR ADDITIONAL COPIES OF THE COMMISSION'S PAPER -- THREE IN ENGLISH AND ONE IN FRENCH.)
GGREENWALD

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